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SUBJECT: SOUTH AFRICA: MINERALS AND ENERGY NEWSLETTER "THE ASSAY" - ISSUE 7, MAY-JUNE 2007

This cable is not for Internet distribution.

¶1. (U) Introduction: The purpose of this monthly newsletter, initiated in January 2004, is to highlight minerals and energy developments in South Africa. This includes trade and investment as well as supply. South Africa hosts world-class deposits of gold, diamonds, platinum group metals, chromium, zinc, titanium, vanadium, iron, manganese, antimony, vermiculite, zircon, alumino-silicates, fluorspar and phosphate rock, and is a major exporter of steam coal. South Africa is also a leading producer and exporter of ferroalloys of chromium, vanadium, and manganese. The information contained in the newsletters is based on public sources and does not reflect the views of the United States Government. End introduction.

Key

¶2. (U) Key to some of the terminology and abbreviations used is given to facilitate understanding.

BEE (Black Economic Empowerment) - the scheme whereby the South African Government promotes black participation in business.

- t = tons,
- t/d = tons per day,
- c/l = cents per liter,
- t/m = tons per month,
- t/y = tons per year,
- oz = troy ounces (31.1 grams),
- cmg = centimeter grams,
- mcf = million cubic feet,

- tcf = trillion cubic feet,
- R = SA currency (rand),
- MW = megawatts,
- kt = thousand tons,
- bbl/d = barrels per day,
- MW = megawatts,
- PGM = platinum group metals.

HOT NEWS

Skills Shortage Beginning to Bite

¶3. (U) The shortage of management and technical skills was cited as one of the causes for the recent poor performance by Lonmin Platinum, the world's third biggest platinum producer. In similar vein, Assmang, South Africa's second biggest producer of

iron ore has acknowledged (de facto) that it has a similar problem. During the current set of industry wage negotiations, the minerals industry has resisted double-digit settlements. By contrast, Assmang has signed an agreement with its three unions for a three-year wage deal that provides for a 15% wage increase in the first year and nine percent a year for the remaining two years. This is substantially above the current (formal) inflation rate of 6.4%. However, it probably takes into account the cost of a prolonged strike to the company, especially during booming demand for iron ore, and food price inflation that is between 8% and 9% for lower paid workers and 12% for poor rural dwellers who spend more than 50% of their income on food. Significantly, in terms of the agreement, a scarcity allowance of $300 per month will be paid to artisans. This underscores the gravity of the skills shortage that the mines are experiencing and that is generally applicable throughout the country. The Solidarity union has long asked companies to consider a skills allowance as a way of retaining skilled staff.

Skills Trouble at Lonmin Platinum

¶4. (U) The performance of Lonmin Platinum (Lonplats), the world's third biggest platinum producer, has been a concern to the market for more than a year. Problems relate to poor management and technical performance on their mines, smelters and refinery, which has impacted the company's financial performance. The third quarter report reflects the difficulties that Lonplats is experiencing. It points out that Lonplats has had to revise its full-year platinum sales expectations down from one million ounces to between 820,000 and 840,000 ounces as a result of the loss of key managers, decreasing grades, and reduced recoveries. Part of the problem has been attributed to

the fact that the top management of the group resides in London and the CEO only spends 10 days a month in South Africa attending to operations. On the production side, smelter recoveries were down 10% due to lower grades and the changing mineral composition of the ore as more UG2 reef is mined - the UG2 contains more palladium and base metals than the traditional Merensky reef for which the plants were originally designed. This issue can only be resolved by changing the constituency of feed to the smelters and by restoring the integrity of the furnaces, which have had numerous shutdowns over the past few years.

U.S.-S.A. PARTNERSHIP

Geophysics Partnership between Pennsylvania State and Witwatersrand Universities

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¶5. (U) During July 16 to 18, the Johannesburg-based Witwatersrand University hosted the 3rd annual AfricaArray workshop. AfricaArray is a joint Wits-Penn State initiative to support capacity building for Africa's resource sector in the field of seismic and remote sensing - used in exploration for minerals and petroleum, tsunami early warning systems, environmental monitoring (climate change), etc. Wits is the only university in Africa with a recognized geophysics program and the objective of AfricaArray is to train geophysicists from the continent to be able to support their respective resource sectors. The planned 20-year initiative provides training for African graduate students at both Wits and Penn State (and other institutions in the EU) and is in the process of establishing an array of scientific observatories and monitoring stations across the continent. It is currently undertaking a number of research and exploration projects on the continent with funding provided by government institutions in the United States and South Africa

and by a number of multinational mining and oil companies. The purpose of the workshop was to provide an update on progress, on research being undertaken, and plans for future work. Walter Mooney of the USGS presented a paper on Earthquake and Tsunami Training in Africa.

PLATINUM

Consolidation for Junior Platinum Producers

¶6. (U) The ongoing boom in price and demand for platinum in particular, but also for its co- and bye-products, such as rhodium, ruthenium, iridium, nickel, copper, cobalt and gold, has given rise to some 20 exploration and mining companies working on more than 30 new and expansion platinum projects on South Africa's Bushveld Complex. Many of the companies are

juniors and do not have the capacity to develop large mines on their own. Most of these projects could not deliver more than 250,000 ounces of platinum group metals each year, mainly in concentrate form, and would have to rely on external smelters and refineries to produce finished metal - roughly 1 million ounces per year is needed to justify a smelter-refinery complex. The lack of these facilities will inevitably lead to consolidation of the smaller operations. There are only three major players with refining and smelting capacity. They are Anglo Platinum (Anglo Plats), Impala Platinum (Implats) and Lonmin Platinum (Lonplats). Each currently has spare capacity and toll or purchase arrangements with smaller producers.

Platinum Supply Increase by 50%

¶7. (U) A junior mining platinum project review by the specialist banking group Investec, estimates that over the next five years 2.5 million ounces of platinum will come from junior projects in South Africa and another 2 million ounces from expansions by the major companies. Thus, the current annual platinum supply of 8 million ounces could increase by more than 50%. Demand is unlikely to increase by this amount and this would result in an over supply of platinum and the other platinum group metals, with a corresponding decrease in prices. Investec does not expect all the junior projects to become mines because they lack the capacity to raise capital or to achieve production targets.

¶8. (U) Currently, there are an estimated 17 shaft-sinking projects in southern Africa and just three companies to do the work. Potential platinum producers have placed orders for long lead items and have secured shaft sinking contractors ahead of completing bankable feasibility studies to avoid the rush for supplies and services. CEO of Wesizwe Platinum, a developing platinum project, believes that there are five to seven years left for the current high platinum group metal (PGM) prices and that juniors needed to get payback on projects in time to survive future softer prices. If prices do come down, the majors, which supply 85% of the world's PGMs, would cut back on expansion plans. In such an environment majors would likely buy out the more promising juniors to remove possible new ounces from the market. However, other majors such as Gold Fields and Xstrata could well take the opportunity to get into the platinum business.

INFRASTRUCTURE

Rail Link to New Coalfield

¶9. (U) Coal has been produced from the Mpumalanga coalfields for nearly 100 years. However, output really only escalated in the 1970's when volume coal exports began and Sasol 2 and 3 plants were commissioned (oil from coal). Currently, these two markets account for 155 million tons per year or 63% of total saleable coal production, most of which comes from Mpumalanga. Reserves contained in these coalfields have declined and production is increasing from other more remote areas. The Waterberg coalfield in Limpopo Province, which spills over into Botswana and becomes the Mmamabula coalfield, is estimated to contain

about 40% of South Africa's remaining exploitable coal resources. It already hosts the 17 million ton per year Grootegeluk coal mine which feeds the adjacent 4,200 Megawatt Matimba power station. Additional development in the Waterberg proposes two similar-sized plants, one next to Matimba (Medupi) and another on the Botswana side. However, if this coal is eventually to complement exports, an upgrade to the existing rail line is a necessity.

¶10. (U) Spoornet, the state-owned railways utility has announced its intention to build a $2.3 billion rail line to connect the Waterberg coal mines to Coega, the deep water port under development in the Eastern Cape Province. A further $114 million is to be used to construct a rail link to Richards Bay Coal Terminal for export to Europe and China. This new investment is in addition to the $5.1 billion already committed for the purchase of new locomotives and wagons and the installation of signal systems over the next five years. Although the power utility, Eskom, will use most of the coal from the new mines, substantial volumes will be available for export. Spoornet has been blamed for chronic capacity constraints and operational inefficiencies, which caused most of its customers to move to road freighters - rail traffic grew by only 0.3% between 1993 and 2004, while road traffic rose 5%. In addition, the number of new trucks on South Africa's roads rose by 16.5% over the past three years, whereas the number of locomotives and wagons decreased by 33% and 28%, respectively. This has caused substantial damage to roads on the affected routes. Spoornet aims to increase its current 10% market share to at least 30% in the next five years.

ELECTRICITY

Cheap Energy a Thing of the Past

¶11. (U) The reserve margin for the state-owned power utility Eskom could fall to 3.8% next year if its peak demand forecast is correct. Operational capacity will grow to 40,000 Megawatts (MW) next year from the current 38,200 MW, but the peak demand forecast of 38,500 MW could trim its reserve margin from 4.2% to 3.8%. Eskom's reserve margin will only start to widen when the new coal-fired Medupi station in Limpopo Province comes on stream from 2011. Mozambican power imports give Eskom an additional 1,490 MW cushion, which will take its reserve to about 7.3% next year - the globally accepted reserve margin is 15%. Peak demand this year has already exceeded forecasts. Demand was expected to peak at 36,300 MW this winter, but reached 36,500 MW on June 27. The return to service of three mothballed power stations will be completed by 2011, which will add 3,800 MW. Likewise, independent producers will generate 1,050 MW and the expansion of the Western Cape's open cycle gas turbine plants will add 2,000 MW by 2009. Eskom wants to lift prices by 13 percentage points above CPIX (consumer price index excluding mortgages and currently running at 6.4%) from next

April and by 12% above CPIX in 2009. This has still to be approved by the National Energy Regulator (NER).

FERRO-ALLOYS

Ferro-Chromium Production to Expand by 150%

¶12. (U) South Africa is the world's biggest producer of ferro-chrome metal. On July 2006, International Ferro Metals (IFM) officially opened its Lesedi chromite mine at a ceremony attended by representatives of the South African, Chinese and Australian governments. IFM is a joint venture between companies from these countries. At the time, IFM also confirmed that the construction of the first phase of its integrated ferrochrome smelting and mining operation at Buffelsfontein in the North West province, was on schedule to achieve a production rate of 267,000 tons of ferrochrome per year by the end of 2007 - phase 1 was officially opened in May 2007. Ferro-chrome is a major constituent of stainless steel.

¶13. (U) On July 9, IFM announced that it had begun a feasibility study to assess the viability of further expanding output from the Buffelsfontein facility to 665,000 tons per year. The expansion would involve the installation of up to three additional 66 MVA furnaces, a 600,000 ton per year palletizing and sintering plant (for aggregating fine material), and a 1.1 million ton per year beneficiation plant, at a capital cost of about $460 million. The company said it expects ferro-chromium demand to grow by 66% between 2007 and 2015. The feasibility study is scheduled for completion in January 2008, with construction to start in March and ramp-up beginning in September 2009. IFM has an off-take agreement with Jiuquan Iron & Steel Group Company (JISCO), the largest steel manufacturer in North West China, for approximately 40% of its ferrochrome production.

DIAMONDS

De Beers Can Again Buy Russian Diamonds

¶14. (U) In February 2006, the European Commission ordered De Beers, the world's top diamond producer to stop buying rough diamonds from Alrosa of Russia, the second biggest diamond producer, on the grounds that this would constitute an abuse of monopoly power. The decree was to take effect from 2009. At the beginning of July, on appeal by Alrosa, the judgement was reversed by a top European court on the grounds that it was disproportionately harsh to prohibit all commercial relations between the two parties after 2009. The court also said that EU regulators had not proved that the two companies held a dominant position in the EU market to justify limiting their business freedom. The decision is not likely to have much effect on the way De Beers does business in other jurisdictions.

¶15. (U) De Beers has been under legal pressures for decades due to its marketing practices. In 2004, the company pleaded guilty to conspiring to fix prices for industrial diamonds and paid a

$10 million fine. This agreement cleared the way for it to

resume selling diamonds in the United States. In November 2005, De Beers agreed to pay $250 million to settle a class action suite in the U.S., brought by previous clients and others who claimed that the company's marketing practices were discriminatory and a restraint of trade. De Beers is also facing regulatory pressures in South Africa for allegedly exporting rough diamonds without properly offering stones to local cutters and polishers. De Beers is also accused of not paying export taxes on a large parcel of diamonds exported just prior to the inauguration of the African National Congress (ANC) government in 1994. The fear of being accused of anti-competitive behavior has effectively prohibited De Beers from buying other operational diamond mines. As a result, during 2007 they will spend $100 million on searching for new mines.

MINING

South Africa's Mining Boom - Missed or Delayed?

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¶16. (U) The decade beginning in the year 2001 has seen unprecedented demand and price increases for mineral commodities, driven principally by China and supported by growth in India, Russia and a number of countries in the Far East. Mineral and mineral-based products account for nearly half of South Africa's export revenues and more than one-sixth of its GDP. Since the start of the commodities boom, South Africa's mineral revenues have increased, mainly as a result of rising prices, but production has not kept pace with international (and domestic) demand.

¶17. (U) More worrying is that investment in mineral exploration and mining has lagged that of competitors, which in turn will delay the ability to increase output. Between 2003 and 2006, South African exploration expenditures increased by 60% (mainly for platinum) while the global average increase was 120%, and South African capital investment decreased by 33%. The SA Chamber of Mines (COM) blames this mainly on: new mining-related legislation and delays in processing license applications and permits. However, other factors also contributed, such as currency volatility and cost escalations, skills shortages, and the time required to bring new production on line.

¶18. (U) There is light at the end of the tunnel. The most recent nine-month investment trend shows an 8% increase in investment and this is likely to be reinforced by government and industry commitments of tens of billions of dollars over the next five years. Government has committed a total of $65 billion to upgrade and expand power, water and bulk mineral transport infrastructure. Industry has committed some $20 billion to increase outputs of gold, platinum, coal, iron ore, uranium, ferro-alloys, and diamonds. Provided that the demand for commodities continues, the country's participation in the commodities boom will have been delayed but not missed. The investment drought is now over.

ENVIRONMENT

Green Tape Choking New Mine Developments

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¶19. (U) Top government officials, including President Mbeki, and industry leaders have long complained about the onerous regulation and time required to get mining and exploration licenses. The problem has been the number of departments involved, including the Department of Minerals and Energy (DME), the Department of the Environment (DEAT) and the Department of Water Affairs and Forestry (DWAF). All lack capacity, each have their own priorities and agendas, and there is little communication or cooperation between or within departments. This has been one of the major reasons for the delay in issuing licenses since 2004.

¶20. (U) Now, Members of the Parliamentary Minerals and Energy Portfolio Committee have been told by DME that the regulatory environment is affecting mining, especially new projects. The DME has accused "over-zealous officials" from the DEAT of demanding a parallel process of compliance for environmental impact assessments and of holding back mining projects that don't meet their criteria. In terms of existing legislation, mining houses need only comply with the DME environmental management specs.

No Scenic Beauty in Poverty - Clouds on Titanium Project

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¶21. (U) The proposed Xolobeni Mining Project in the Eastern Cape is an example of the above "Green Tape" problem. The Australian mining company MRC Resources has, after nearly three years of exploration and legal challenges by environmentalists, applied for a mining license from the Department of Minerals and Energy (DME), which has been accepted. This could lead to a $2.5 billion titanium mine and create 550 jobs in one of South Africa's poorest regions with the highest unemployment. The area to be mined is a remote, difficult to access, severely eroded strip of land set back from the coast and away from estuaries and other sensitive areas with tourism potential. Exploration results show that the area hosts one of the world's top ten titanium resources containing an estimated nine million tons of titanium.

¶22. (U) However, the area is also renowned for its natural beauty. Ecologists want the area ring-fenced for tourism and protected for future generations. They also oppose an extension to the N2 national highway that would open the area to mining, and presumably to tourism, which they also seem to oppose. The local communities in favor of development say they are impoverished and have waited for the development and jobs promised from ecotourism but nothing has happened. The mine will ensure that they finally have access to electricity, water, a sewerage system, and schools for their children. South

Africa's Mining Charter also provides for the local communities to buy (with government and industry assistance) a 26% stake in the mine. The whole issue has fueled emotions in a classic standoff between ecologists and environmentalists on the one side and miners, the DME, and local communities on the other. The government is keen for the mine to go ahead but environmental challenges could still delay, if not permanently derail, production start up planned for 2010.

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